No. 7835

In the United States Circuit Court of Appeals for the Ninth Circuit

R. J. RICHARDS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The only previous opinion in the present case is that of the United States Board of Tax Appeals (R. 32–43), which is reported in 30 B. T. A. 1131.

JURISDICTION

This petition for review involves income taxes for the years 1927 and 1928 in the respective sums of $486.69 and $12,552.81, and was taken from a decision of the Board of Tax Appeals entered July 12, 1934 (R. 43). The case is brought to this Court by petition for review filed September 28, 1934 (R. 45–48), pursuant to the provisions of Sections 1001–1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

QUESTION PRESENTED

Where the taxpayer subdivided and improved three successive tracts of land, which operations continued over a period of at least three years, were the lots held by the taxpayer primarily for sale in the course of business, or were they capital assets within the meaning of the capital gain provisions?

STATUTE INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 101. CAPITAL NET GAINS AND LOSSES.
>
> (a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.
>
> * * * * *
>
> (c) *Definitions.*—For the purposes of this title—
>
> * * * * *
>
> (8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind

> which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

(Section 208 (a) (8) of the Revenue Act of 1926 is substantially the same as the section quoted above.)

STATEMENT

The material facts as found by the Board (R. 33–38) are as follows:

The petitioner and his wife made joint income-tax returns for the years 1927 and 1928. The real property involved was acquired by them as joint tenants with the right of survivorship.

Since prior to 1920 the petitioner, for himself or as a member of a partnership, has been engaged in the business of raising, packing, buying, and marketing farm products, particularly lettuce. About September 15, 1920, petitioner and his wife acquired title to approximately forty-seven acres of land in Los Angeles County, California. About April 30, 1921, they acquired another tract adjoining the above trust, containing about four acres. About March 11, 1922, they acquired title to a third piece of land adjacent to the foregoing tracts. These tracts of land at the time of acquisition lay in a very productive farming area and were used by the petitioner in the raising of lettuce and sometimes chicory and endive.

After the petitioner acquired these properties there was a great deal of real-estate activity in the lands between his property and the boundary of the city of Los Angeles. The intervening property began to be subdivided and sold, with the result that the petitioner's property rapidly increased in value until it arrived at a value in excess of $4,000 an acre without improvements. Taxes and assessments for local improvements also increased. This increase made the use of these lands and the adjacent lands for gardening purposes unprofitable.

In 1925 petitioner determined to subdivide a part of the first parcel of land which he had purchased. In pursuance of this plan on July 15, 1925, he conveyed a portion of the property to the Security Trust & Savings Bank of Los Angeles, hereinafter referred to as the bank, which accepted it in trust to secure a note of $28,500 which petitioner and his wife owed the bank, and upon further trust to subdivide and sell the property conveyed. Under the deed of trust (R. 72–110) petitioner and his wife agreed to pay all taxes and assessments levied on the property, to pay principal and interest on all indebtedness secured by the trust, to pay all claims, liens, and encumbrances and defend all suits affecting the property, to pay for all improvements ordered by him or his agent, and to file with the trustee a copy of each contract for improvements to be placed on the property. The property was to

be subdivided and improved by the petitioner and his wife.

The deed contained provisions which permitted the trustee, upon default of petitioner and his wife in paying the above amounts, to pay them itself, and gave it recourse against the property. The trustee was authorized to rent, sell, and convey the property or any part thereof to such persons and at such times as it deemed best, provided the sale prices of the lands should not be less than those indicated in the schedule to be filed with the deed. The proceeds received from the sales were to be used to pay commissions and to release liens, the balance to go in what was termed a general fund, out of which the cost and expenses of the trust and certain other expenses were to be paid, and what remained over was to be paid to the petitioner and his wife.

The deed recites (R. 84) that at the request of the petitioner and his wife it appointed P. N. Snyder "as their exclusive agent to subdivide and improve, and to solicit and obtain purchasers for such part of said property" as was subdivided. He was paid a commission, out of which he was to pay for advertising and other selling expenses of himself and his subagents. Among the duties assumed by the agent was the general care and custody of the subdivided property, and of all improvements placed upon the property, which included the installation of gas, water, and electricity. The trustee was not required to procure any insurance on

any building upon the property, or to collect or disburse any rentals therefrom. These duties were to be performed by the petitioner and his wife.

Upon payment in full of the indebtedness secured by the deed and at the reqeust in writing of petitioner and his wife, the trustee was given authority to close and terminate the trust, but was not required to do so as long as any of the covenants contained in any deed remained unperformed. The petitioner and his wife furnished the trustee a list (R. 111–114) of the minimum prices at which the lots were to be sold. The number of lots was 186. The minimum price was $1,250 and the maximum price was $40,000 per lot.

The sales of lots in the first subdivision having proved satisfactory, petitioner determined to subdivide other portions of the property above described. By deed of August 6, 1926, the bank accepted in trust property previously conveyed. The provisions of this trust deed (R. 114–143) resembled the one of July 15, 1925. Afterward, the petitioner and his wife determined to subdivide and sell the remaining portion of the property purchased as hereinabove set forth, and by deed of trust (R. 144–171) dated January 12, 1927, the bank accepted such property on practically the same trusts as those provided in the deed of July 15, 1925.

The principal reason for the above conveyances was to have all deeds on lots promptly executed, especially in the absence of the petitioner from Los

Angeles. The number of lots in the second subdivision above set forth was eighty-two. The number of lots in the third subdivision was one hundred fifty-two. In the third subdivision the minimum price for the lots was $1,200 and the maximum was $15,000. Under each of the deeds, Snyder was appointed by the bank as petitioner's exclusive agent, at their request, for a term of eight months, with the right to serve eight months more upon achieving certain results, and upon the termination of his employment the trustee was to appoint as agent for the petitioner and his wife such person as they directed, all sales, however, to be subject to the approval of the trustee of the bank.

The petitioner's business of producing, packing, and selling lettuce and other vegetables increased from year to year, and he substituted, either by lease or purchase, farming properties for the properties which he subdivided.

The petitioner, himself, has never taken part in the subdivision or the sale of the lots in the subdivisions, all of which was done by Snyder. Except as herein set forth, the petitioner has never engaged in the business of buying and selling real estate or dealt therein. He has not been licensed as a broker to buy or sell real estate.

The Board found that the lots were held by the taxpayer primarily for sale in the course of his business, and concluded that he was not entitled to the benefits of Sections 208 of the Revenue Act of 1926, and 101 of the Revenue Act of 1928.

ARGUMENT

The pertinent portion of the statute quoted above defines capital assets as property "held by the taxpayer for more than two years * * * but does not include * * * property held by the taxpayer primarily for sale in the course of his trade or business * * *." The taxpayer seeks to come within the capital gain provisions so as to pay income tax on the profits in question on the level rate of 12½ percent rather than on the normal sliding scale of tax and surtax on individual incomes. The statutory definition excludes from capital assets property held primarily for sale in the course of a trade or business. The lots of the subdivision here involved were admittedly held by the taxpayer primarily for sale, so the only question before the court is whether or not the taxpayer was engaged in a business.

When the operation of the properties for farming purposes became unprofitable, the taxpayer decided to subdivide and sell them (R. 56). In doing this he engaged in three separate and distinct subdivision projects, all of which extended over the period of time involved in the present proceedings. The subdivision of the property, which was then adapted only to farming, was not a simple business operation. (See charts, R. 114, 144, 174.) Many things were involved, such as engineering features, drainage, sewers, grading and paving of streets, sidewalks, curbs, the subdivision of the property into lots so as to afford access to the vari-

ous conveniences; and there were involved matters of organization, sales, advertising, the furnishing of certificates of title, financial arrangements, and numerous other details that called for judgment and management (R. 78).

When the taxpayer saw that the first project was going over successfully, he entered upon the second project, and then later upon the third. These were operations of considerable magnitude. The total number of lots in the three subdivisions was four hundred and twenty, and the prices ranged from $1,200 to $40,000 per lot (R. 37). The operations were spread over a period of four or five years. The Government submits that they constitute business operations on the part of the taxpayer within the meaning of the pertinent revenue statute.

The fact that the taxpayer engaged a selling agent is immaterial. The selling was a relatively simple feature of the business operation. The burden was upon the taxpayer to formulate and execute the plans for subdividing and improving the property preparatory to the sales. In any event the acts of the agent in such a case are the acts of the taxpayer. Furthermore, it was immaterial, for present purposes, that when the sales were made the legal title was in the bank as trustee. As pointed out by the Board (R. 39), the conveyances were made to the bank for two purposes—first, to secure the bank for its loan then made to the taxpayer and for advances thereafter to be

made; and, second, to facilitate the execution and delivery of deeds to purchasers of the lots in the absence of the taxpayer. Nor is it of any particular import that the taxpayer's principal business was that of raising and selling farm produce. One may be engaged in several businesses at the same time.

The taxpayer relies upon the proposition that the properties sold in the three subdivision projects were acquired for the purpose of raising produce and that they could not have been held primarily for sale in the course of a subdivision business. If this case were controlled by the Revenue Act of 1921, such an argument would have some force. Section 206 (a) (6) of the Revenue Act of 1921, c. 136, 42 Stat. 227, did require that the property be "acquired and held * * * for profit or investment * * *", but all the subsequent revenue acts omitted the word "acquired." The purpose of the change made in the revenue act was to remove any doubt as to whether the statute referred to property held primarily for sale, whether or not it was included in inventory. See H. Rep. No. 179, 68th Cong., 1st Sess., p. 57.

In the recent case of *Roney* v. *Commissioner,* 67 F. (2d) 165 (C. C. A. 4th), certiorari denied, 290 U. S. 705, the court pointed out that, even though slight, the activities of the taxpayer were continuously carried on between the years 1922 and 1925, and concluded that (p. 166) "very slight activity constitutes 'doing business' when the end is profit."

In *Sloan* v. *Commissioner,* 63 F. (2d) 666, this Court said (p. 669):

> As said by the Supreme Court in the case of *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 171, 31 S. Ct. 342, 357, 55 L. Ed. 389, Ann. Cas. 1912B, 1312: " 'Business' is a very comprehensive term and embraces everything about which a person can be employed. Black's Law Dict., 158, citing *People* v. *Commissioners of Taxes,* 23 N. Y. 242, 244. 'That which occupies the time, attention, and labor of men for the purpose of a livelihood or profit.' Bouvier's Law Dict. [vol. 1], p. 273."

In *Welch* v. *Commissioner,* 19 B. T. A. 394, affirmed *per curiam,* 59 F. (2d) 1085 (C. C. A. 6th), it was held that the subdivided property was held by the taxpayer primarily for sale in the course of his business although, due to ill health, he gave little personal attention to the developments, and though the lots were sold by many different real estate agents. In the more recent case of *Pope* v. *Commissioner,* 77 F. (2d) 599 (C. C. A. 6th), the court reversed the Board's decision and allowed the treatment of the gain realized from the sale of lots as a capital gain. The following excerpt from the opinion clearly distinguishes such case from the one now before the court (p. 600):

> It may be assumed that Miller and the Essex Company were engaged in the real-estate business, but the status of their profits is not in controversy. The question is whether a director and officer of a corporation, owning

> a substantial amount of its stock but not active in its affairs, is engaged in the business in which the corporation is engaged.

The case of *Phipps* v. *Commissioner,* 54 F. (2d) 469 (C. C. A. 2d), is likewise distinguishable from the instant case. That the court there recognized the principles here urged is evidenced by the following excerpt from the opinion (p. 471):

> There should be a greater continuity and larger absorption of time in such transactions to make the taxpayers more than investors. A fair reading of the record makes it clear that nothing was done during the years in question but to hold land for sale which had been previously purchased, and to accept such offers from purchasers as were presented by brokers and seemed satisfactory. There was during the years in question no activity amounting to a trade or business within the meaning of the statute, and whether there was such a trade or business depended on the situation of the taxpayers at the time of the sale. They had not continuously engaged in the development and sale, or the purchase and sale of lands.

It is submitted that the principles of law involved in cases of this type are clear. The decision in each instance must depend upon the particular facts before the court. *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503. The sole question presented on this review is whether the evidence is legally sufficient to sustain the Board's finding that the lands were held by the taxpayer primarily for

sale in the course of his trade or business. *Phillips* v. *Commissioner,* 283 U. S. 589; *Pope* v. *Commissioner, supra.*

On page twenty-four of his brief, taxpayer contends that when the land itself was no longer valuable in his produce business, the disposition of it amounted to a liquidation, but to that extent only, conceding that he was not liquidating his produce business. The cases there cited do not fit this case. In this Court's decision in *Commissioner* v. *Atherton,* 50 F. (2d) 740, where the issue was whether the trust formed for the liquidation and distribution of real estate holdings of a transit company was a pure trust or an association taxable as a corporation, it was pointed out (p. 741) that "there was and is nothing that required the time, attention, or labor of any one for profit or for livelihood." There the land, in its existing condition, was listed with general land agents for sale. The trustees "did no business except to collect rent on the parcels involved, pay taxes and expenses thereon." Such a case is clearly distinguishable from the one at bar, where the lands held were not being sold as such but were, through the involved and continuous efforts of the taxpayer and his own agents, converted into a new type. The Board correctly found (R. 41) that "what he has done is to take certain assets individually owned and devoted them to a new purpose."

It is submitted that the evidence amply supported the Board's finding that the taxpayer was

engaged in the subdivision business during the years involved.

CONCLUSION

Since the lots were held by the taxpayer primarily for sale in the course of his business, the profits arising from the sale of those lots are not subject to the capital gain provisions of the statute. The decision of the Board of Tax Appeals should be affirmed.

Respectfully submitted.

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